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No. 88-54

Supreme Court, U.S.

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In The
Supreme Court of the United States

October Term, 1988

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MICHAEL VITIELLO,

on behalf of himself and the certified class of
DATA ACCESS SYSTEMS, INC., shareholders,

Petitioner,

v.

**I. KAHLOWSKY & CO., PETER CUNICELLI,
TOLINS & LOWENFELS, and
ROGER A. TOLINS,**

Respondents.

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**BRIEF OF RESPONDENTS I. KAHLOWSKY & CO.
AND PETER CUNICELLI IN OPPOSITION TO
PETITION FOR WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT**

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QUESTIONS PRESENTED

1. Whether, consistent with the approach outlined by the Court in *DelCostello*, *Wilson* and *Agency Holding*, the statute of limitations enacted by Congress for express rights of action under the securities acts, rather than an inexact patchwork of state laws, provides a more appropriate source for borrowing the most analogous statute of limitations applicable to claims under § 10(b) of the Securities Exchange Act of 1934?
2. Should not the borrowed statute, selected because it best reflects Congressional intent and federal securities policy, be applied in the manner that Congress intended—as absolute and not subject to tolling?

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STATEMENT OF THE CASE

This case involves application by the Court of Appeals of the principles announced in *DelCostello v. Teamsters, Wilson v. Garcia* and *Agency Holding Corp. v. Malley-Duff & Associates, Inc.* The Third Circuit Court of Appeals unanimously held that, in light of Congressional philosophy and purposes set forth in the Securities Act of 1933 and the Securities Exchange Act of 1934, the express limitations periods under the 1934 Act provides the proper source of limitations borrowing for violations of § 10(b) and Rule 10b-5 securities claims. *In Re: Data Access Systems Securities Litigation*, 843 F.2d 1537 (3d Cir. 1988) (*in banc*).

The issue arose in a securities class action suit brought by purchasers of Data Access Systems, Inc. ("DASI") common stock between October 31, 1978 and June 22, 1981. The first shareholder complaint was filed on June 23, 1981. Other complaints followed. First and Second Consolidated Amended Class Action Complaints were filed on October 26, 1981 and May 18, 1982 respectively. The allegations in the First Class Action Complaint pertain to the 1979 DASI offering prospectus, which was alleged to be false and misleading. The Second Class Action Complaint was filed to incorporate additional claims in the wake of a March 1982 report issued by a special agent appointed by the district court in connection with a related SEC enforcement action against DASI.

I. Kahlowsky & Co. and Peter Cunicelli ("Kahlowsky and Cunicelli"), respondents here, were not named in the initial complaints or the First or Second Amended Class

Action Complaints. Kahlowsky and Cunicelli were not named as parties to any DASI-related litigation until a Third Amended Complaint was filed on January 7, 1986—more than six years after the prospectus was issued and more than four years after the special agent issued his report. The Third Amended Complaint alleges, at ¶15, that Kahlowsky and Cunicelli conspired to defraud the DASI shareholders by providing false and incomplete information to DASI's auditors, Touche Ross, concerning the nature of transactions between DASI and Mark Serv, Met-Fab Corporation and Bubble Systems (Pet. App. 7ba).

While Petitioners contend that they did not "discover" the facts giving rise to the claims against Kahlowsky and Cunicelli until sometime in 1985, when they happened to see a copy of a deposition of Cunicelli taken in 1984 by Touche Ross in a related DASI proceeding, they knew or should have known the facts on which these allegations are based long before that. Kahlowsky and Cunicelli were identified as auditors of the DASI-related companies in the 1979 prospectus. Moreover, the special agent's report identifies Kahlowsky as the accountants for Mark Serv Corp., Mark Serv Co., Met-Fab and Bubble, and identifies Cunicelli as the principal of the Kahlowsky firm. The present claims are based on the very same transactions and nucleus of facts described by the special agent, though the special agent ascribed no wrongdoing to Kahlowsky or Cunicelli. The Second Amended Complaint, filed as a result of this report, alleged that "other persons . . . not named or made defendants herein have participated as co-conspirators in offenses charged in this Complaint and

have performed acts and made statements in furtherance thereof" (Resp. Tolins App. 13). In addition, the fact and substance of communications between Kahlowsky and Cunicelli are documented in the workpapers of Touche Ross, also a defendant, which were apparently made available to petitioners early in the litigation.

Nonetheless, it was not until June 1984 that the deposition of Cunicelli was taken. Even then this deposition was noticed by Touche Ross in a related proceeding and not the petitioners. The alleged inculpatory statements, which were identified by petitioners in responses to discovery, are virtually the same in scope and substance to statements made by Cunicelli in an SEC proceedings involving DASI on March 23, 1981. The inescapable conclusion that petitioners discovered or should have discovered the claims against Kahlowsky and Cunicelli long before 1985, and that the delay in bringing suit was deliberate, is further supported by the fact that permission to file the Third Amended Complaint was not sought until immediately after a partial settlement was reached between petitioners and Touche Ross.

After the complaint was filed in the district court, Kahlowsky and Cunicelli immediately moved to dismiss on the ground that the claims were barred by the two year limitations provision of the New Jersey blue sky law. The motion asserted that this was the applicable statute in light of then-existing Third Circuit precedent and, also, under the newly announced approach of this Court in *Wilson v. Garcia*, 471 U.S. 261 (1985). The district court denied the motion but certified the issue for immediate interlocutory review.

The Third Circuit Court of Appeals accepted the case for review. Kahlowsky and Cunicelli argued in their appeal brief that the court should adopt a uniform federal statute of limitations derived from the limitations periods for express actions under the securities laws in light of this Court's decision in *Agency Holding Corp. v. Malley-Duff & Associates, Inc.*, — U.S. —, 107 S. Ct. 2759 (1987), which had just been announced. In the Court of Appeals, petitioners never argued that the federal statute should not be borrowed because it is not subject to equitable tolling. The *in banc* court unanimously adopted a uniform statute borrowed from federal law but remanded the case to the district court to decide whether the ruling should apply to the parties in this case. Three judges, while agreeing on the uniform statute adopted, did reach the retroactivity issue and dissented on the ground that the rule should be applied prospectively only. Before the remand issued, petitioners were granted a stay of the mandate to file the petition now before the Court.

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SUMMARY OF ARGUMENT

Review by this Court is unwarranted because recent opinions in *DelCostello*, *Wilson* and *Agency Holding* have set forth in detail the guidelines and rationale of the Court's new approach to borrowing a statute of limitations where none is provided by Congress. No need exists for the Court to reaffirm the Court of Appeals' proper application of these principles here.

Review is also unnecessary because the decision does not conflict with any decision of this Court or another appeals court. Petitioners' assertion that decisions of this Court mandate resort to state, not federal, law has already been considered by the Court and rejected. In addition, the Court of Appeals reading of the borrowed "one year, three year" statute as absolute does not conflict with decisions of the Court on equitable tolling. No decision of the Court has ever required the application of equitable tolling where, as in the case of the securities laws, Congress has expressed a clear intent that the time for discovery and bringing a claim be limited to three years and no more. The appeals court reading of the statute is consistent with decisions of this Court holding that the intent of Congress is determinative of whether unlimited tolling will apply.

Finally, this case is not an appropriate one to review these issues in any event because: (1) the applicability of the ruling of the parties is uncertain, (2) petitioners did not raise the tolling issue in the Court of Appeals and the issue is not preserved for review, and (3) petitioners' § 10(b) claim is barred under the "one year discovery prong" of the borrowed statute, thereby precluding the necessity to review the tolling question presented here.

ARGUMENT WHY THE PETITION SHOULD BE DENIED

- I. THE PROPRIETY OF RESORT TO FEDERAL LAW IN IMPLEMENTING THE BORROWING APPROACH ANNOUNCED IN WILSON V. GARCIA HAS BEEN PREVIOUSLY CONSIDERED AND APPROVED BY THE COURT IN AGENCY HOLDING; THE COURT NEED NOT REAFFIRM EVERY PROPER APPLICATION OF THESE PRINCIPLES.

Petitioners do not quarrel with the Court of Appeals' conclusion that *Wilson v. Garcia*, 471 U.S. 261 (1985), requires that a uniform limitations period be adopted for implied rights of action under § 10(b). Rather, petitioners contend that review by this Court is necessary because Supreme Court precedent requires borrowing of a *state* limitations period. Petition at 13. The Court has already considered this question and held in *Agency Holding Corp. v. Malley-Duff & Associates, Inc.*, — U.S. —, 107 S.Ct. 2759 (1987), that the Rules of Decision Act, 28 U.S.C. § 1652 requires application of state statutes of limitations *unless* federal law provides a closer, more appropriate analogy. The appeals court decision, the first to address the question after *Agency Holding*, is in complete accord with the holdings of this Court. Moreover, no "conflict" among the circuits exists; all of the "contrary" decisions cited by petitioners were decided prior to the Court's pronouncement in *Agency Holding*. Therefore, review by this Court is unnecessary.

In *Wilson v. Garcia*, the Court announced a new approach to "borrowing" the appropriate limitations period for federal statutes where none is provided. The Court

found that federal interests outweigh deference to state statutes of repose where resort to state statutes breeds uncertainty, unnecessary litigation and inconsistent results contrary to the substantive federal policies at stake and held that uniform characterization of all 42 U.S.C. § 1983 claims arising within a given state best serves federal policy and Congressional intent.

Thereafter, in *Agency Holding Corp. v. Malley-Duff & Associates, Inc.*, the Court applied *Wilson* to the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. § 1964 ("RICO") and held that it is a federal statute that offers the closest analogy to civil RICO. In so doing, the Court emphasized that "when a rule from elsewhere in federal law clearly provides a closer analogy than available state statutes, and when the federal policies at stake and the practicalities of litigation make that rule a significantly more appropriate vehicle for interstitial law-making, we have not hesitated to turn away from state law." *Agency Holding*, 107 S.Ct. at 2763, quoting *DelCostello v. Teamsters*, 462 U.S. 151, 171-172 (1983). The Court held that "the similarities in purpose and structure between RICO and the Clayton Act" together with "the clear legislative intent to pattern RICO's civil enforcement provision on the Clayton Act strongly counsels in favor of application of the 4-year statute of limitations used for Clayton Act claims." *Agency Holding*, 107 S.Ct. at 2765. The Court also held that the practicalities of RICO litigation provide equally compelling reasons for the desirability of a uniform federal statute because of the "multistate nature" of RICO. 107 S.Ct. at 2766.

The Court of Appeals' adoption of a federal statute of limitations drawn from elsewhere in the securities acts

for all § 10(b) securities cases is an obviously consistent application of *Wilson* in accord with what the Third Circuit viewed as a "strong signal" from this Court in *Agency Holding*. As with RICO, § 10(b) claims have been analogized to a variety of state statutes of limitation, resulting in time-consuming litigation and creating disparities between buyers and sellers and between investors in different states such as were never intended by Congress. As with RICO, state law provides an inexact and unsatisfactory vehicle for enforcement of federal law. The nationwide implications of the securities laws demand national uniformity. As with RICO, federal law provides a "closer analogy" and "more appropriate vehicle for interstitial lawmaking". See *Agency Holding*, 107 S.Ct. at 2763. Judge Easterbrook, in *Norris v. Wirtz*, 818 F.2d 1329 (7th Cir.), *cert. denied*, — U.S. —, 108 S.Ct. 329 (1987), aptly stated:

As practitioners and scholars agree that the result is a mess, they also believe that the courts missed a turn. Courts should have drawn the periods of limitations for the implied rights from the periods of limitations for the express rights. Congress has not been silent about limitations for securities laws in general, the usual problem that leads federal courts to turn to state law; it has been silent only with respect to rights of action it did not create. Whenever it created a federal right to sue, it also created a statute of repose no longer than three years. That is what the courts should have used. 818 F.2d at 1333.

See also, L. Loss, Fundamentals of Securities Regulation, 1168-69 (1983) ("Would it not be eminently more consistent with the overall statutory scheme to look to what Congress itself did when it was thinking specifically of

private actions in securities cases than to a grab-bag of more or less analogous state statutes?"').

The Supreme Court has now, in *Agency Holding*, "opened the door to borrowing federal limitations statutes". *In Re: Data Access Systems Securities Litigation*, 843 F.2d 1537, 1549 (3d Cir. 1988) (*in banc*). The Court of Appeals has applied the principles of *Wilson v. Garcia* and *DelCostello v. Teamsters* to implied rights of action under § 10(b) of the Securities Exchange Act in exactly the same manner as this Court did in *Agency Holding* for RICO. Recent decisions of this Court have amply defined this new approach, and the reasons for it, and there is no need for the Court to reaffirm the proper application of these principles by the Court of Appeals here.

II. UNLIMITED TOLLING IS CONTRARY TO THE EXPRESS INTENT OF CONGRESS TO EXTINGUISH LIABILITY UNDER THE SECURITIES ACT AFTER THREE YEARS; THE BORROWED STATUTE SHOULD BE APPLIED AS CONGRESS INTENDED.

The equitable tolling doctrine has no application where, as in the case of the securities laws, Congress has addressed the tolling issue in the statute itself and expressed an intent in the legislative history to limit the time for discovery of claims as part of the overall enforcement scheme.

This Court has said that the question of whether a statute of limitations is to be tolled is determined by whether the legislature intended that the right be enforceable after the time prescribed. *Burnett v. New York Central R. Co.*, 380 U.S. 424, 426 (1965); *Midstate Horticultural Co. v. Pennsylvania R. Co.*, 320 U.S. 356, 360 (1943).

Just last session, the Court stated that while it is proper to consider policy considerations in construing the securities laws, the "broad remedial goals of the Securities Act are insufficient justification for interpreting a specific provision more broadly than its language and the statutory scheme reasonably permit." *Pinter v. Dahl*, — U.S. —, 108 S.Ct. 2063, 2082 (1988), citing *Touche Ross & Co. v. Redington*, 442 U.S. 560, 578 (1979). The Court of Appeals' reading of the borrowed statute as mandating an absolute three year limit for discovering and bringing securities claims is consistent with the precedent of the Court.

No decision of this Court requires or has held that unlimited equitable tolling must be read into a statute where Congress has stated an intent to the contrary. The cases cited by petitioners in which the Court applied equitable tolling involve instances where Congress was presumably silent on the issue and, unlike the case here, there is no evidence that Congress intended the statute to be absolute. *See, e.g., Explorations Co. v. United States*, 247 U.S. 435 (1918). In no case cited by petitioners or uncovered in respondent's research where the doctrine of equitable tolling was applied did the Court have before it a statute containing its own "built-in" tolling provision as found in the securities acts.

The intent of Congress to limit the time for discovery of claims is nowhere more evident than in the language and legislative history of the securities acts. The plain language of the borrowed "one year, three year" limitations period for express rights of actions under the securities statute supports the conclusion that Congress intended the outside three year period to be absolute. One district

court interpreting an analogous statute which also contains a "built-in tolling provision" (Interstate Land Sales Full Disclosure Act, 15 U.S.C. § 1711) has persuasively stated:

"Where the statute expressly provides for a tolling period for fraudulent concealment, and then includes a secondary date which 'in no event' can be surmounted, there is good basis for the belief that the latter date was intended as an absolute barrier to the filing of suits."

Timmreck v. Munn, 433 F.Supp. 396, 408 (N.D. Ill. 1977), quoted in *Aldrich v. McCulloch Properties, Inc.*, 627 F.2d 1036, 1043 (10th Cir. 1980). A similar reading of the securities laws is also consistent with the long-standing doctrine of statutory construction to give effect to every word used by Congress in a statute. *Reiter v. Sonotone Corp.*, 442 U.S. 330, 339 (1979). To accept petitioners' position, any claim brought within one year of the date of discovery would be timely, and the language "in no event more than three years from the date of the violation" would be rendered superfluous. The use of the words "in no event" further supports the conclusion that Congress did not intend for claims to be brought for any reason after expiration of the three year period. See *A.J. Phillips Co. v. Grand Trunk Western Railway Co.*, 236 U.S. 662, 667 (1915) (language of Commerce Act that claims be brought "within two years *and not after* (emphasis added)" indicates that purpose of statute is to prevent suits on delayed claims); *Finn v. United States*, 123 U.S. 227 (1887) (similar conclusion where statute stated that claims not brought within specified period were "forever barred").

The legislative history of the 1934 Act provides clear expressions that Congress did not intend equitable tolling to be read into the prescribed limitations periods. During an extensive Senate debate, the participants agreed that the outside limitations period was to be absolute:

If [a plaintiff] has been injured and finds that he has been injured, he ought to bring his action within a reasonable time, and we fix that time at 1 year. *If he has not discovered it*, the person who made the misrepresentation or false statement ought to feel safe at some reasonable time that he will not be disturbed.

78 Cong. Rec. 8198 (emphasis added) (remarks of Senator Fletcher). The Senate Bill as reported out of Committee originally set the outside time period at six years, about which Senator Barkley commented: "In this bill as it is written we give a man six years in which to discover whether or not a fraud has been committed on him. After that six-year period he cannot bring suit." 78 Cong. Rec. at 8198. This was subsequently reduced to three years. Congress was concerned that a longer statute might "deter men from serving on boards of directors". *Id.* at 8200. Concerns about the disruptive effects that long statutes of limitations would have on the business community also prompted Congress to amend the 1933 Act limitations statute, 15 U.S.C. § 77m, from a "two year from date of discovery, but in no event more than ten years after the sale" to a "one year, three year" statute similar to those enacted for the express rights of action in the 1934 Act. As stated in a recent ABA Task Force Report, the conclusion is "inescapable . . . that Congress did not intend equitable tolling to apply in actions under the securities laws."

Report of the Task Force on Statutes of Limitations for Implied Actions, 41 Bus. Law. 645, 655 (1986). See also 6 J.S. Ellenberger & Ellen P. Mahar, Legislative History of the Securities Act of 1933 and Securities Exchange Act of 1934, 6565-66, 6718, 6993 (1973).

In view of the fact that the limitations period for express rights of action under the securities act is the most appropriate source of determining what Congress would have intended with respect to an implied action under §10(b), and the very reason to borrow that statute in the first place, it makes little sense to then incorporate equitable tolling when applying that statute to § 10(b). Such a result would not only be directly contrary to the clear intent of Congress, but would render the entire borrowing process a useless exercise. The fact that Congress affirmatively rejected the concept of equitable tolling for all express rights of action under the securities law, even those involving fraud, see, e.g., 15 U.S.C. § 77m (governing the timeliness of § 12(2) claims), is clear evidence that Congress intended such a doctrine to apply to the implied § 10(b) right of action. As this Court has observed in *Board of Regents v. Tomanio*, 446 U.S. 478 (1980), where it held that the "borrowing" of state limitations law includes rules of tolling, "[a]ny period of limitation . . . is understood fully only in the context of the various circumstances that suspend it from running. . . ." 446 U.S. at 486, quoting *Johnson v. Railway Express Agency, Inc.*, 421 U.S. 454, 463-464 (1975). That concept has even greater applicability when the statute is "borrowed" from the very same legislative scheme enacted by Congress.

III. REVIEW OF THESE ISSUES IN THIS CASE IS INAPPROPRIATE BECAUSE (1) THE DECISION MAY NOT APPLY TO THE PARTIES, (2) PETITIONERS NEVER RAISED OR PRESERVED THE EQUITABLE TOLLING ISSUE BELOW, AND (3) PETITIONERS SECURITIES CLAIMS ARE BARRED BY THE ONE YEAR PRONG OF THE BORROWED STATUTE THUS PRECLUDING THE NEED TO REACH THE TOLLING QUESTION RAISED HERE.

This case is not an appropriate one in which to review the questions presented in any event. First, because the issue arose in the form of an interlocutory appeal and the district court did not address the issue, the Court of Appeals did not reach the question of whether its decision should be applied to the parties in this case. While a subsequent Third Circuit panel decision applied the *Data Access* decision retroactively in another case, *Hill v. Equitable Trust Co.*, 851 F.2d 691 (3d Cir. 1988), the three dissenting judges below would not accord the benefit of the decision to the parties here. Thus, whether the parties have a definite stake in the outcome of the questions presented remains uncertain. Second, even though respondents argued for the national federal statute adopted by the Court of Appeals, after *Agency Holding* was decided by this Court, petitioners never argued that the "one year, three year rule" should not be borrowed because it contains a built-in tolling cut off. Thus, the tolling issue was never an issue in contention below, petitioners have not preserved the question for review and it would be inappropriate to consider the issue now. Finally, petitioners have no stake in the tolling question raised here because petitioners' claims are barred under the one year discovery

prong of the borrowed statute regardless of whether the three year period is tolled. Petitioners discovered or should have discovered the claims alleged against Kahlowsky and Cunicelli more than one year before the Third Amended Complaint was filed on January 7, 1986.

CONCLUSION

For the foregoing reasons, the petition for writ of certiorari should be denied.

Respectfully submitted,

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